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No. 45

In the Supreme Court of the United States

OCTOBER TERM, 1954

FEDERAL POWER COMMISSION, PETITIONER

v.

COLORADO INTERSTATE GAS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL POWER COMMISSION

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We believe that our main brief disposes of the various contentions advanced by Colorado. However, since the Company strenuously presses arguments predicated on the specification, in its application for rehearing, in regard to the Commission's calculation of the income tax component of the cost of service, further elaboration on this point, beyond the summary comment in our main brief (p. 17, fn. 6), may be helpful to the Court.

The argument in Colorado's brief based on this specification is not completely clear. While the primary contention appears to be that this specification was sufficient under Section 19 (b) of the Natural Gas Act to preserve for judicial review the

question of the validity of the merger condition (Br. pp. 15–19), there are also indications in the brief (see e. g., pp. 12, 15) that Colorado's point is that, although the assigned error as to the income tax component was not the basis of the Court of Appeals' reversal, the error thus assertedly committed by the Commission constitutes an alternative and separate justification for that judgment. Each of these arguments is without merit.

1. Taking the second contention first, it is clear that the alleged error as to the income tax component cannot constitute an alternative ground for the reversal below. The exclusion of the $456,665 item of income tax from the cost of service stemmed from the Commission's finding of a $420,000 loss from gasoline operations. Since this loss was, under the merger condition, to be excluded from cost of service, the result was to reduce Colorado's income tax liability under the Commission's computation by $456,665. The income tax item was dependent upon the exclusion of the gasoline loss, which, in turn, depended upon the validity of the merger condition. The consequence is that the total exclusion ultimately dependent upon the validity of the merger condition embraced not only the $420,000 gasoline loss but also the related income tax, or a total (including a State income tax component of $13,700) of $892,000. See the Commission's main brief, p. 6, fn. 3. Thus, even if the Company were correct in its view as to the income tax (as

distinguished from the gasoline loss), the correctness of that contention could not support a judgment based on consideration of the entire $892,000. Moreover, the Court of Appeals expressly recognized that its holding that the merger condition was invalid and its concomitant reversal of the exclusion of the gasoline loss will "require further consideration of the item of federal income taxes as an element of the cost of service" (R. 277). These two considerations remove any possibility that the alleged error in computing the income tax component at $456,665, even if committed by the Commission,[1] could support the reversal below on the invalidity of the merger condition.

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[1] We do not, of course, concede that the Commission's calculation of the income tax component was erroneous. On the contrary, we believe the computation to be entirely correct, and consistent with the Commission's established practice of allowing as income tax the actual tax liability to be incurred. See, e. g., *In re Transcontinental Gas Pipe Line Corporation*, F. P. C. Docket G–1842, at R. 112, and p. 17 of Colorado's Br. Colorado's argument on this score appears to be that since the Commission for regulatory purposes eliminated the gasoline loss from the cost of service, the Commission should have computed the income tax liability as if the gasoline loss had not been incurred. The Commission's refusal to adopt Colorado's approach, Colorado urges, has the effect of further reducing the return allowed. But the fact is that, under Colorado's theory, its income tax liability would be artificially increased to a figure $456,665 in excess of the actual tax liability. Since this sum would be retained by Colorado, and not actually disbursed as taxes, the result would be, as the Commission pointed out (R. 127–128), that the actual return to Colorado would be increased by the $456,665 less the resulting additional income tax, and thereby offset in substantial part the gasoline loss. On the other

2. Nor is Colorado's claim any more substantial if it be that its objection in the application for rehearing to the income tax component satisfied the requirements of Section 19 (b) of the Gas Act, so as to preserve for judicial scrutiny the validity *vel non* of the merger condition.

(a) In dealing with this matter, it is important to stress Colorado's explicit admission that its specification of errors *in regard to the gasoline loss itself* "assumed" "the *propriety* of the deduction" if the loss were properly determined (Br. p. 16, fn. 10, emphasis added), and went only to "contentions in regard to the method, the failure to use the appropriate factors under the adopted method, the lack of substantial evidence to sustain the conclusion that there was a loss, and to the contention that the method adopted violated the certificate condition (R. 98–103, 106–114)" (Br. p. 16, see also pp. 2, 12). As already shown in our main brief (pp. 14–25), those assignments fall far short of satisfying the requirements of Section 19 (b) of the Gas Act, particularly when they are read against the background and history of the merger condition.

(b) Since the specifications dealing with the gasoline loss—which was directly related to the condition—did not raise the issue of the condi-

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hand, under the Commission's approach Colorado would receive the full return to which it was entitled, less, of course, the gasoline loss in accordance with the terms of the merger condition, together with the actual taxes based thereon.

tion's validity, it is extremely unlikely that the issue would be raised by the specification dealing with the income tax component—which, while stemming from the gasoline loss, bore only indirectly upon the merger condition. And the plain fact is that the condition's validity was *not* raised by the income tax specification. On the contrary, that specification, like those dealing with the gasoline loss, appears to have accepted the condition's validity as a basic premise.

Specification No. 40, the sole specification on the income tax component, alleged merely (R. 103):

> 40. The Commission erred in not allowing to Colorado Federal Income Taxes and State Income Taxes, associated with the 5¾ per cent rate of return found by the Commission to be reasonable and, in fact the Commission has reduced the allowed rate of return from 5¾ per cent to 5.01 per cent.

Clearly, the wording of this specification fell far short of apprising the Commission that Colorado was by indirection attacking the condition, which Colorado had affirmatively pressed upon the Commission in the merger proceeding and which it had not questioned directly in the specifications dealing with the gasoline loss (see the Commission's main brief, pp. 14–25).

Nor would the discussion in the application for rehearing relative to this specification so advise the Commission. See R. 112–114. As the quotation from the Commission's opinion in *In re*

> in the cost of service of the $421,537. To accede to Colorado's contention, however, is to nullify the removal of the $421,537 from the costs which the customers of Colorado should bear. [Emphasis added.]

(c) Apparently recognizing that its income tax specification did not in and of itself attack the merger condition, Colorado argues that the Commission was apprised that the validity of the merger condition was in issue by the allegations that the Commission's action on income taxes resulted in a reduction in the Company's return and that the exclusion of the gasoline loss also had a similar result (see Colorado's Br., pp. 16–21). But, as already indicated, Colorado had alleged specific error in regard to the Commission's calculation of income taxes—an alleged error not only without bearing on the merger condition but explicitly assuming its validity. Such an allegation—even more, since more remote, than the specification on the calculation of the gasoline loss—failed to inform the Commission that the merger condition was under attack. See our main brief, pp. 18–20. Consequently, even assuming, as Colorado contends (Br. pp. 17–18), that the gasoline loss and the income taxes were fused by the Commission, the Company's assigning as error of the Commission's method of calculating income taxes falls far short of preserving for judicial review, under Section 19[a] (b), the

merger condition's validity. For Colorado's complaints as to both components of the "fusion"—gasoline loss and income tax—assumed that the condition was valid and proceeded from that point.

Moreover, to construe the income tax specification as putting the Company's return in general issue would not help Colorado here. Since there are many elements which go to make up the return, such a general assignment would not advise the Commission which of the numerous components of the return were being questioned. Certainly, it would not apprise the Commission that, having espoused the condition in the merger proceeding, Colorado had reversed its position and was now attacking the condition. For that reason, as we have pointed out in our main brief, pp. 20–21, the support which Colorado seeks from *May Stores Co.* v. *National Labor Relations Board*, 326 U. S. 376, does not exist, and this case falls squarely within the principle applied in *Marshall Field & Company* v. *National Labor Relations Board*, 318 U. S. 253; and *National Labor Relations Board* v. *Seven-Up Bottling Co.*, 344 U. S. 344. And as we have also noted in our main brief, pp. 24–25, the fact that this is a rate case, in which Colorado challenges the "end result" of the rate set by the Commission, does not change the rule.

CONCLUSION

For the foregoing reasons, and those set out in our main brief, the judgment of the court below should be reversed to the extent that it invalidates the condition pursuant to which the Commission excluded from cost of service Colorado's losses from the gasoline operations.

Respectfully submitted.

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The Court below reversed because of a fundamental error of law committed by the Commission. An adequate rate of return is a fundamental right which must be awarded in order to avoid confiscation of property. This Court has determined that such a rate must be one that will enable a company to operate successfully, maintain its financial integrity, attract capital and compensate the investors for assumed risks. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591, 605 (1944). The Commission purported to allow Colorado a rate of return of 5¾%.[3] However, from this rate of return calculated to give the company $3,280,317 (R. 125), the Commission deducted $87,202 (R. 115, 198). What the Commission did could otherwise be stated as a deduction from Colorado's legitimate operating expenses. Regardless of how the matter is considered, the effect is the same. Since the Commission allowed the rate of return on a "bare bones" cost of money basis any deduction from return is confiscatory, and since expenses must be allowed as part of the composition of rates (see *Mississippi River Fuel Corporation* v. *Federal Power Commission*, 163 F. 2d 433, 437 (D. C. Cir. 1947)) the deduction in either event was improper.

The situation leading to the deduction which the Court below would not allow arises from the peculiar background circumstances of this case—*i.e.*, the consideration for the transfer of stock incident to the merger which was the subject of the precedent certificate proceedings. No amount of discussion can vary this fact.[4]

[3] Whether that rate was properly allowed or not is the subject of one of the questions in the cross-petition in No. 777.

[4] Additionally, the issue decided adversely to the Commission below will probably be of importance to this one case alone and will not materially affect future rate determinations even relating to Colorado. This is so because the Commission on April 15, 1954 adopted its Opinion No. 269 (*In re Panhandle Eastern Pipe Line Company, et al.*, not yet reported), wherein it treated hydrocarbon